

OPEN MEETING ITEM



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COMMISSIONERS
KRISTIN K. MAYES - Chairman
GARY PIERCE
PAUL NEWMAN
SANDRA D. KENNEDY
BOB STUMP



ARIZONA CORPORATION COMMISSION

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2010 JUN -7 A 9:33

DOCKET CONTROL

ORIGINAL

DATE: JUNE 7, 2010
DOCKET NO.: T-03267A-09-0475

TO ALL PARTIES:

Enclosed please find the recommendation of Administrative Law Judge Belinda A. Martin. The recommendation has been filed in the form of an Order on:

MCLEODUSA TELECOMMUNICATIONS SERVICES, INC.
D/B/A PAETEC BUSINESS SERVICES
(FINANCE)

Pursuant to A.A.C. R14-3-110(B), you may file exceptions to the recommendation of the Administrative Law Judge by filing an original and thirteen (13) copies of the exceptions with the Commission's Docket Control at the address listed below by **4:00** p.m. on or before:

JUNE 16, 2010

The enclosed is NOT an order of the Commission, but a recommendation of the Administrative Law Judge to the Commissioners. Consideration of this matter has tentatively been scheduled for the Commission's Open Meeting to be held on:

JUNE 29, 2010 AND JUNE 30, 2010

For more information, you may contact Docket Control at (602) 542-3477 or the Hearing Division at (602) 542-4250. For information about the Open Meeting, contact the Executive Director's Office at (602) 542-3931.

Arizona Corporation Commission
DOCKETED

JUN - 7 2010

DOCKETED BY [Signature]

[Signature]
ERNEST G. JOHNSON
EXECUTIVE DIRECTOR

1200 WEST WASHINGTON STREET; PHOENIX, ARIZONA 85007-2927 / 400 WEST CONGRESS STREET; TUCSON, ARIZONA 85701-1347
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This document is available in alternative formats by contacting Shaylin Bernal, ADA Coordinator, voice phone number 602-542-3931, E-mail SABernal@azcc.gov

1 **BEFORE THE ARIZONA CORPORATION COMMISSION**

2 COMMISSIONERS

3 KRISTIN K. MAYES, Chairman
4 GARY PIERCE
5 PAUL NEWMAN
6 SANDRA D. KENNEDY
7 BOB STUMP

7 IN THE MATTER OF THE APPLICATION OF
8 MCLEODUSA TELECOMMUNICATIONS
9 SERVICES, INC., D/B/A PAETEC BUSINESS
10 SERVICES FOR A FINANCING ORDER
11 AUTHORIZING VARIOUS FINANCING
12 TRANSACTIONS.

DOCKET NO. T-03267A-09-0475

ORDER

10 Open Meeting
11 June 29 and 30, 2010
12 Phoenix, Arizona

12 **BY THE COMMISSION:**

13 Having considered the entire record herein and being fully advised in the premises, the
14 Arizona Corporation Commission ("Commission") finds, concludes, and orders that:

15 FINDINGS OF FACT

16 Procedural History

17 1. On October 2, 2009, McLeodUSA Telecommunications Services, Inc., d/b/a PAETEC
18 Business Services ("PAETEC" or "Applicant"), filed with the Commission an application for
19 approval to pledge its Arizona assets as security for certain debt financing arrangements up to
20 \$700,000,000, pursuant to A.R.S. § 40-285 and Arizona Administrative Code ("A.A.C.") R14-2-804
21 ("Application").

22 2. The Applicant caused notice of the Application to be published in the *Arizona*
23 *Business Gazette* on November 23, 2009.

24 3. On January 25, 2010, the Commission's Utilities Division ("Staff") filed a Staff
25 Report recommending conditional approval of the Application.

26 4. On February 18, 2010, the Applicant filed a Notice of Transaction and Request for
27 Retroactive Authority ("Notice"). In its Notice, PAETEC stated that in order to take advantage of
28

1 favorable market conditions, it had closed a financing transaction on January 7, 2010. As such,
2 PAETEC requested that any order granting the Application be retroactive to January 1, 2010. The
3 Notice failed to provide any information about the specific terms and conditions underlying the
4 transaction.¹

5 5. On March 12, 2010, a Procedural Order was filed directing Staff to “conduct any
6 additional discovery necessary to address the information provided in the Applicant’s Notice and [to]
7 file a Supplemental Staff Report, including updated recommendations, if any...”

8 6. On March 26, 2010, Staff filed its Supplemental Staff Report stating, “Staff concluded
9 that the request for Retroactive Authority is reasonable. Staff also finds that no further discovery is
10 necessary in regard to this request.”²

11 7. On April 7, 2010, a Procedural Order was filed noting that A.R.S. § 40-301(C)
12 requires that the Commission find that a proposed financing is for lawful purposes within the
13 corporate powers of an applicant, are compatible with the public interest, with sound financial
14 practices and will not impair its ability to perform that service. The Procedural Order also noted that
15 A.R.S. § 40-302(A) states that Commission approval is required before a public service corporation
16 may issue stocks and stock certificates, bonds, notes and other evidences of indebtedness. The
17 Procedural Order directed the Applicant to file with Docket Control a supplement to its Application
18 containing the following information regarding the transaction that closed on January 7, 2010:

- 19 a) The amount of the financing;
20 b) The structure of the financing;
21 c) The terms of the financing, including, but not limited to, interest rate and
22 maturity dates;
23 d) The lender or lenders under the financing; and
24 e) Any other information the Applicant believed necessary.

25 8. The Procedural Order also directed Staff to file an Updated Supplemental Staff Report
26

27 ¹ Although the transaction closed before Staff issued its Staff Report, the Applicant’s Notice did not indicate why it failed
28 to notify Staff of the closing so that Staff could consider the actual terms and conditions of the transaction in Staff’s
original Staff Report.

² Supplemental Staff Report, page 1.

1 based on PAETEC's supplement.

2 9. On April 16, 2010, PAETEC filed its Supplement to Application and Response to
3 Procedural Order ("Supplement"), providing the required information, and asserting that Commission
4 approval of the transaction terms is not required under A.R.S. § 40-301(D) and § 40-302(A) because
5 the Applicant is a foreign public service corporation.

6 10. On May 10, 2010, Staff filed its Updated Supplemental Staff Report agreeing with
7 PAETEC's assertion that Commission approval of the transaction is not required pursuant A.R.S. §
8 40-301 (D).³

9 11. On May 26, 2010, PAETEC filed its Comments on Staff's Updated Supplemental
10 Staff Report requesting that the Commission consider this matter at open meeting as soon as possible
11 and waiving the ten-day exception period.

12 **The Parties**

13 12. PAETEC is an Iowa corporation authorized in Arizona to provide resold and facilities-
14 based local exchange access telecommunications services pursuant to Decision No. 62627 (June 9,
15 2000). PAETEC is also authorized to provide resold interexchange telecommunications services
16 pursuant to Decision No. 61001 (July 16, 1998). PAETEC also provides resold and/or facilities-
17 based telecommunications services in 48 states and the District of Columbia. The Applicant
18 generated over \$1 million in Arizona jurisdictional revenue and as such, PAETEC is a Class A utility
19 subject to the Commission's Affiliated Interest Rules, A.A.C. R14-2-801, *et seq.*

20 13. PAETEC is an indirect wholly-owned subsidiary of PAETEC Holding Corp.
21 ("Parent"). The Parent is a publicly-traded Delaware corporation. In Arizona, the Parent provides
22 regulated communications services through three wholly-owned subsidiaries: PAETEC, PAETEC
23 Communications, Inc. ("PCI"),⁴ and US LEC Communications, Inc. ("US LEC").⁵

24 ³ Nevertheless, Commission review and approval of the transaction is required under A.R.S. § 40-285 and A.A.C. R14-2-
25 804. See Findings of Fact No. 29-32.

26 ⁴ PCI is authorized in Arizona to provide resold intrastate interexchange services pursuant to Decision No. 62458 (April
27 14, 2000). PAETEC states that PCI is not a party to the Application because it has no physical presence in Arizona and is
28 not a Class A investor-owned utility subject to the terms of A.A.C. R14-2-804.

⁵ US LEC is authorized to provide resold intrastate interexchange services in Arizona pursuant to Decision No. 66740
(January 20, 2004). According to the Application, US LEC is not a party to the Application because it has no physical
presence in Arizona and is not a Class A investor-owned utility subject to A.A.C. R14-2-804. Additionally, PAETEC
notes that US LEC ceased operation in Arizona in 2007 and had application pending before the Commission for

1 14. Staff states that there are no compliance issues with the Applicant.

2 **Existing Long-Term Debt of Parent**

3 15. In Decision No. 70126 (January 23, 2008), the Commission approved the merger of
4 the Parent with PAETEC's then ultimate corporate parent, McLeod USA Incorporated. The Decision
5 also authorized, upon consummation of the merger, PAETEC's participation in certain of the Parent's
6 debt financing arrangements.

7 16. Decision No. 70126 authorized a total of \$1.35 billion in aggregate principal amount
8 of all indebtedness. According to the Application, the Parent's indebtedness currently consists of 1) a
9 term loan of approximately \$241 million aggregate principal amount and a revolving loan of \$50
10 million aggregate principal amount, both outstanding under Senior Secured Credit Facilities, 2) \$300
11 million aggregate principal amount of Senior Notes, and 3) \$350 million aggregate principal amount
12 in Senior Secured Notes. PAETEC notes that it still has authorization to incur, guarantee and/or
13 secure up to \$150 million in additional indebtedness. The Decision did not set a termination date for
14 the debt authorization.

15 **The Financing**

16 17. The Applicant states its reason for the additional authorization as follows:

17 PAETEC Parent anticipates that over the next five years it will enter into various
18 financing arrangements including, but not limited to, transactions to amend,
19 restate, and/or refinance long-term debt, finance new capital expenditures, and
20 obtain funding for general corporate purposes and working capital. In order for
21 PAETEC Parent to capture market conditions favorable to such arrangements,
22 PAETEC Business needs the flexibility to immediately participate in such
23 financing transactions before such conditions change and the opportunity to take
24 advantage of favorable financing conditions and other business opportunities is
25 lost. Accordingly, PAETEC Business requests an order providing it with the
26 flexibility to participate in various financing transactions and related
27 arrangements as follows:

1. Authorization under A.R.S. §40-285 to encumber its Arizona assets as
24 security for up to \$700 million in additional long-term indebtedness of PAETEC
25 Parent (and, as applicable, its subsidiaries, including Applicant). The requested
26 authorization is in addition to the approval already granted by the Commission in
27 Decision No. 70126;

2. Authorization under A.A.C. R14-2-804 to guarantee the obligations of

28 cancellation of its Certificate of Convenience and Necessity in Docket No. T-04194A-07-0624. The application for
cancellation was approved in Decision No. 71326 (October 30, 2009).

1 PAETEC Parent (and, as applicable, its other subsidiaries) for up to \$700 million
 2 in additional long-term indebtedness. The requested authorization, which would
 3 cover the execution and delivery of one or more guarantees, pledge and security
 4 agreements, and such other agreements as may be required, is in addition to the
 5 approval separately obtained in Decision No. 70126; and

6 3. Authorization to participate in various financing arrangements related to
 7 any restructuring, refinancing and/or financing of any long-term indebtedness of
 8 PAETEC Parent (and, as applicable, its subsidiaries, including Applicant) covered
 9 by the authorization granted in paragraphs 1 and 2 immediately preceding and by
 10 Decision No. 70126, so long as the total long-term indebtedness at any one time
 11 outstanding complies with such conditions as the Commission determines are
 12 necessary to include in its order approving this Application ("Financing Order").
 13 The authorization to participate in such related financing arrangements shall
 14 permit refinancings, refundings, renewals, reissuances, and rollovers of any such
 15 indebtedness outstanding, the incurrence or issuance of additional long-term
 16 indebtedness, and the amendment or revision of any terms or provisions of, or
 17 relating to, any long-term indebtedness.⁶

18 18. According to PAETEC's Supplement, under the terms of transaction which closed on
 19 January 7, 2010, the Parent issued \$300 million in senior secured notes ("Notes"). According to
 20 PAETEC, the key terms of this transaction are as follows:

21 Initial Purchasers: Banc of America Securities LLC and Deutsche Bank
 22 Securities Inc.

23 Maturity: The Notes will mature on June 30, 2017.

24 Interest Rate: Interest on the Notes will accrue at a rate of 8 7/8 percent per
 25 annum.

26 Interest Payments: The Notes will pay interest semi-annually in cash in arrears on
 27 June 30 and December 31 of each year, beginning on June 30, 2010.

28 Guarantees: The Notes will be guaranteed on a senior secured basis by the
 Parent's domestic restricted subsidiaries in existence on the issue date and by all
 of its future domestic restricted subsidiaries, other than certain excluded
 subsidiaries.

Ranking: The Notes and the guarantees will be the Parent's general obligations
 and will rank equally in right of payment with all of its existing and future senior
 indebtedness and senior right of payment to all of its existing and future
 subordinated indebtedness.

Security: The Notes and the guarantees will be secured on a first-priority basis,
 equally and ratably with the Parent's senior secured credit facilities, existing notes
 and any future *pari passu* secured obligations, subject to permitted liens, by
 substantially all of the Parent's assets.

⁶ Application, pages 2-3.

1 19. The remaining \$400 million of requested authorization will remain subject to the
2 general terms stated in the Application. PAETEC notes that the exact amounts and terms of any
3 financing transaction pursuant to the additional authorization may be completed in multiple tranches
4 and will not be finalized until the specific terms and conditions of each transaction have been agreed
5 upon. The Applicant expects that each transaction will reflect the market conditions then existing
6 and certain of the terms, such as the interest rate, may vary during the term of the financing due to
7 changes in market conditions and the financial condition of the Parent.

8 20. PAETEC states that the funding providers may be banks, financial institutions, private
9 lending institutions, private individuals, and/or other institutions, either individually or a consortium.

10 21. According to PAETEC, portions of the financed funds may be in the form of
11 conventional credit facilities, such as revolving credits, letters of credit, secured or unsecured notes or
12 debentures issued to banks, other types of financial institutions or other investors, and term loans.

13 22. The anticipated maturity date or dates will be subject to negotiation and will depend
14 on credit conditions, but the Applicant expects all maturity dates will be longer than one year.

15 23. PAETEC asserts that any interest rate likely will be the market rate for similar
16 financings and will not be set until the financing is finalized. The Applicant notes that any negotiated
17 interest rate will be the market rate for similar financings and will not be determined until finalization
18 of a transaction.

19 24. As security for these transactions, PAETEC expects that some, and perhaps all, of the
20 loans to the Parent will be secured by a security interest in substantially all of PAETEC's assets
21 and/or stock. PAETEC notes that the security documents will contain appropriate provisions
22 indicating that exercise of certain rights may be subject to obtaining prior regulatory approval.

23 25. The Application states that the proceeds will be used to repay existing debt and for
24 capital expenses, working capital and general corporate purposes. The Applicant notes that the
25 proceeds of any such transactions may be used to pay fees and expenses incurred in connection with
26 such arrangements.

27 26. The Applicant asserts that the proposed financings are purely financial in nature and
28 will not alter the rates, terms, conditions or services offered by PAETEC in Arizona. PAETEC will

1 remain a wholly-owned subsidiary of the Parent and will continue to operate as a provider of
2 telecommunications services in Arizona, and PAETEC states that the transaction will be transparent
3 to its Arizona customers.

4 27. PAETEC also assert that the flexibility afforded by the requested authorization enables
5 the Parent to strengthen its financial condition, thereby creating opportunities to enhance PAETEC's
6 competitive position in the Arizona telecommunications market, which will inure to the benefit of its
7 Arizona customers.

8 28. Additionally, PAETEC notes that it currently has a \$600,000 performance bond on file
9 with the Commission, the purpose of which is to protect its Arizona customers who have prepaid for
10 service or provided deposits.

11 **Statutory and Regulatory Issues**

12 29. Staff notes that A.A.C. R14-2-804(B) provides that a Class A Utility may not obtain a
13 financial interest in any affiliate not regulated by the Commission, or guarantee or assume the
14 liabilities of such an affiliate without Commission approval. Under A.A.C. R-14-2-804(C), the
15 Commission must review the transaction to determine if it would impair the financial status of the
16 public utility, otherwise prevent it from attracting capital at fair and reasonable terms, or impair the
17 ability of the public utility to provide safe, reasonable, and adequate service.

18 30. Staff determined that under A.A.C. R14-2-804, the proposed transaction will not
19 impair the Applicant's financial status, prevent it from attracting capital at fair and reasonable terms,
20 or impair the ability of the Applicant to provide safe, reasonable and adequate service.

21 31. As PAETEC and Staff note, A.R.S. § 40-301 provides that foreign public service
22 corporations providing communications services within the state whose physical facilities are also
23 used in providing communications service in interstate commerce are not required to obtain
24 authorization from the Commission to issue stocks and stock certificates, bonds, notes, and other
25 evidences of indebtedness payable at periods of more than twelve months. Because the Applicant is a
26 foreign public service corporation whose physical facilities are also used in providing
27 communications services in interstate commerce, pursuant to A.R.S. § 40-301(D), the Applicant's
28 proposed financing is exempt from Commission approval.

1 32. However, A.R.S § 40-285 requires public service corporations to obtain Commission
2 authorization to encumber certain utility assets. The statute serves to protect captive customers from
3 a utility's disposition of assets that are necessary for the provision of service, thereby preventing any
4 service impairment due to disposal of critical assets necessary to provide service.

5 **Staff Recommendations**

6 33. Based on its review of the proposed transaction as stated in the Application, Staff
7 determined that the pledge of the Applicant's Arizona assets would not impair the availability of
8 service to the customers since the Applicant provides competitive services that are available from
9 alternative service providers. However, Staff recommends that, because customers who have prepaid
10 for service or made deposits may have exposure to losses, any authorization for encumbrances should
11 include customer protection for prepayments and deposits.

12 34. Staff recommends approval of the Applicant's request to encumber its assets in the
13 State of Arizona in connection with financings of up to \$700 million.

14 35. As noted above, PAETEC currently has on file with the Commission a \$600,000
15 performance bond in order to protect Arizona customers from any losses.

16 36. Staff recommends that such authorization should be subject to the condition that
17 PAETEC's \$600,000 performance bond on file with the Commission be kept current on a yearly
18 basis.

19 37. Staff recommends that the Applicant be authorized to engage in any transactions and
20 to execute or cause to be executed any documents necessary to effectuate the authorizations requested
21 in the Application.

22 38. Staff also recommends that the Applicant file with Docket Control, as a compliance
23 item in this matter, within 60 days of the execution of any financing transaction herein authorized, a
24 copy of the loan documents. Because the Applicant has already entered into a transaction using \$300
25 million of the requested \$700 million authorization, PAETEC shall file with Docket Control, as a
26 compliance item in this matter, within 30 days of the effective date of this Decision, copies of the
27 loan documents executed on January 7, 2010.

28 39. Staff recommends that the authorization granted herein terminate on June 30, 2013.

1 **Retroactive Applicability**

2 40. On February 18, 2010, the Applicant filed its Notice of Transaction and Request for
3 Retroactive Authority. In the Notice, PAETEC advised that in January 2010 the Parent was
4 “presented with a very favorable financing opportunity that would significantly enhance the corporate
5 financial position.”⁷ Accordingly, because of the fluidity of the debt market, the Parent believed it to
6 be in its and its customers’ best interests to secure favorable financing immediately that would
7 improve its financial cost structure and flexibility. As such, PAETEC closed the transaction on
8 January 7, 2010.

9 41. The Notices states, “[u]nder the new financing, [PAETEC] continues to guarantee its
10 parent’s debt and its assets continue to be encumbered to secure its parent’s debt. However,
11 [PAETEC] also continues to hold a \$600,000 performance bond and neither the bond nor its Arizona
12 deposits are part of the new guarantee and encumbrance.”⁸

13 42. Although A.R.S § 40-285 requires public service corporations to obtain Commission
14 authorization prior to encumbrance of certain utility assets, the Applicant points out that pursuant to
15 Decision No. 70126, PAETEC was already guaranteeing the Parent’s debt and its assets were already
16 encumbered. PAETEC asserts that it needed to move swiftly to capture favorable market conditions
17 in order to obtain significant financial benefits.

18 43. As such, PAETEC requests that, if the Commission grants the Application and
19 authorizes the debt, such authorization be retroactive to January 1, 2010. PAETEC states that it
20 understands that it will be bound by all the conditions of the Decision. Staff did not object to the
21 Applicant’s request.

22 44. Because of the current market conditions, and because PAETEC is already
23 guaranteeing the Parent’s debt and its assets are already encumbered, the requested modification is
24 reasonable.

25 45. Staff’s recommendations are reasonable and should be adopted.
26
27

28 ⁷ Notice, page 1.

⁸ Notice, page 2.

CONCLUSIONS OF LAW

1
2 1. PAETEC is a public service corporations within the meaning of Article XV of the
3 Arizona Constitution, A.R.S. § 40-285.

4 2. The Commission has jurisdiction over PAETEC and the subject matter of the
5 Application.

6 3. Notice of the Application was given in accordance with the law.

7 4. The encumbrance approved herein pursuant to A.R.S. § 40-285 is for the purposes
8 stated in the Application and is reasonably necessary for those purposes.

9 5. Pursuant to A.A.C. R14-2-804 the proposed transactions will not impair the financial
10 status of the Applicant, prevent it from attracting capital at fair and reasonable terms, or impair the
11 ability of the Applicant to provide safe, reasonable and adequate service.

12 6. Staff's recommendations are reasonable and shall be adopted.

13 **ORDER**

14 IT IS THEREFORE ORDERED that the Application by McLeodUSA Telecommunications
15 Services, Inc., d/b/a PAETEC Business Services for authorization to encumber assets as security for
16 debt financing up to \$700 million as provided for herein is granted.

17 IT IS FURTHER ORDERED that this approval is retroactive to January 1, 2010.

18 IT IS FURTHER ORDERED that McLeodUSA Telecommunications Services, Inc., d/b/a
19 PAETEC Business Services' \$600,000 performance bond on file with the Commission shall be kept
20 current on a yearly basis.

21 IT IS FURTHER ORDERED that McLeodUSA Telecommunications Services, Inc., d/b/a
22 PAETEC Business Services, is hereby authorized to engage in any transactions and to execute or
23 cause to be executed any documents in order to effectuate the granted authorization.

24 IT IS FURTHER ORDERED that McLeodUSA Telecommunications Services, Inc., d/b/a
25 PAETEC Business Services shall file with Docket Control, as a compliance item in this matter,
26 within 60 days of the completion of any financing transaction herein authorized, copies of the
27 executed loan documents.

28 IT IS FURTHER ORDERED that McLeodUSA Telecommunications Services, Inc., d/b/a

1 PAETEC Business Service shall file with Docket Control, as a compliance item in this matter, within
2 30 days of the effective date of this Decision, a copy of the loan documents executed on January 7,
3 2010.

4 IT IS FURTHER ORDERED that the authorization granted herein will terminate on June 30,
5 2013.

6 IT IS FURTHER ORDERED that this Decision shall become effective immediately.

7 BY ORDER OF THE ARIZONA CORPORATION COMMISSION.
8
9

10 CHAIRMAN

COMMISSIONER

11
12 COMMISSIONER

COMMISSIONER

COMMISSIONER

13
14 IN WITNESS WHEREOF, I, ERNEST G. JOHNSON,
15 Executive Director of the Arizona Corporation Commission,
16 have hereunto set my hand and caused the official seal of the
17 Commission to be affixed at the Capitol, in the City of Phoenix,
18 this _____ day of _____, 2010.

19
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21 _____
22 ERNEST G. JOHNSON
23 EXECUTIVE DIRECTOR

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